

BEFORE THE  
POSTAL RATE COMMISSION  
WASHINGTON, D.C. 20268-0001

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POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

**INITIAL BRIEF OF THE  
ASSOCIATION OF ALTERNATE POSTAL SYSTEMS**

The Association of Alternate Postal Systems has a single point to make in this proceeding, and it is a simple one. Its members compete with the Postal Service for the delivery of advertising material, and under the Postal Reorganization Act, the impact of rate changes on its member companies must be taken into consideration. In prior cases the Postal Rate Commission has done so. On the other hand, the Postal Service once again has not. Notwithstanding the Postal Service's contentions to the contrary, the proposed reduction in the pound rate for Standard A ECR mail, limited to those weights at which competition is greatest, has been designed to and, the uncontroverted evidence shows, will in fact cause a substantial shift of volume from alternate delivery. Such a shift could well complete the job of destruction that began when Periodicals were stripped away from the alternate delivery industry several years ago.

AAPS has presented comprehensive testimony before this Commission for more than twenty years, and even though the testimonial torch has now been passed to its current Executive Director, John White, the core concerns remain the same. Mr. White manages Distribution Systems of Oklahoma (DSO), an alternate delivery company that provides service in central Oklahoma, primarily the Oklahoma City area. His product, similar to that for the industry as a whole, consists of saturation advertising, phone books, product samples and small community newspapers. Also typical of the industry, DSO offers flexible and audited delivery

service that usually provides effective competition for the Postal Service and that provides a choice to consumers.

However, the industry's ability to compete was dealt a severe blow following the 1995 reclassification decision, which led to the end of alternate delivery of magazines<sup>1</sup> and a reduction in the rate for lightweight ECR pieces. An even more significant blow would be dealt by lowering the pound rate, as proposed in this case, and it would in many cases finish the job and wipe out the only effective competition for the Postal Service in much of the advertising delivery market.

Mr. White testified that the pound rate reduction would permit the mailing of shared mail packages at prices that are lower than alternate delivery costs (Tr. 9940). The resulting loss of volume, he testified, would have the effect of "forcing alternate delivery companies out of business" (*id.*). William Wilson, a witness for NAA with substantial experience in the alternate delivery business, including shutting down operations in the face of reduced postage rates (Tr. 19135-36, 19412), stated bluntly (at Tr. 19136) that "lowering the pound rate could easily be the death knell of the alternate delivery industry."

AAPS recognizes, and will later deal specifically with, claims that the costs to the advertiser of obtaining alternate delivery are in many or even most cases lower than the costs of obtaining postal delivery. Surely, the costs of alternate delivery vary widely by market, just as the costs *to the advertiser* of postal delivery as part of a shared mail set can vary widely, depending in large part on the number of pieces in and the weight of the set. What this record

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<sup>1</sup> Mr. White testified (Tr. 9939) that, prior to the reduction in rate for high density Periodicals, his company delivered 175,000 magazines monthly, with revenues of more than \$400,000, not counting the revenues from accompanying advertisements. When that volume disappeared after moderate rate reductions for high density Periodicals, 27 jobs were lost, and more than \$40,000 of investment in hardware was idled. Mr. White testified (*id.*) without rebuttal or challenge that many alternate delivery companies did not survive, and those that did lost a good deal of their credibility. This testimony was confirmed by that of William Wilson, who noted (Tr. 19142) that Knight Ridder had soon after the 1996 rate changes shut down 25 of its 28 alternate delivery operations, switching from 90% hand delivery to 80% postal delivery.

establishes is that the current relationship between alternate delivery costs and prices, on one hand, and postal costs and prices, on the other, appear to be in a state of equipoise. Postal volumes are growing, the alternate delivery industry is hanging on and recovering slowly from the loss of periodicals. Moreover, the overwhelming majority of mailers are staying in the mail (even when, like Mr. Bradpiece (Tr. 18911), they claim that they could save as much as 66% on delivery costs by leaving the mail), and ADVO, the biggest ECR mailer, has completed sixteen straight quarters of record profits (Tr. 19041). Unfortunately, we must rely upon public sources for information about ADVO, because it has chosen to present testimony only at the rebuttal stage (even though both AISOP and SMC filed testimony at the direct testimony stage), thus immunizing itself from discovery.

AAPS's contention that the industry, from a macro sense, is in equilibrium can be demonstrated by the consistent testimony of those who seek increased profits and a tilt in the market in the form of a rate reduction. Thus, witness Baro testified (Tr. 14373) for AISOP that it is important to "maintain," not to create, reasonable rates for ECR mail and that (Tr. 14376) he depends upon the USPS "keeping saturation rates affordable." AISOP's other witness, Mr. Smith, echoed these views, stating (Tr. 14546) that today's saturation rates are reasonable and that "saturation advertising mail is probably the most cost-effective and reasonable for the smallest and newest businesses." Postal Service rebuttal witness O'Hara also recognized that today's rates provide mailers with an affordable option (Tr. 21964).

Witness Merriman, for SMC, testified (Tr. 15661) that the steady postal rates for the past five years have been "reasonable," and that both his advertisers and his readers have benefited. In fact, Mr. Merriman asserted that the ECR rates that have been in effect—and that AAPS submits can and should remain in effect—"have been beneficial to my business" and have produced his "greatest circulation growth" (Tr. 15562). He also agreed (Tr. 15676) that the benefits of the past five years would not be diminished if rates were to remain stable.

No discussion of ECR mail users would be complete, of course, without inclusion of ADVO. Like the others seeking to lower costs and increase profits,<sup>2</sup> ADVO supports a pound rate reduction. Yet, ADVO's Mr. Giuliano (testifying for SMC) confirmed the relative balance in the industry by noting that ADVO's business is expanding in both the alternate delivery (Tr. 19001-02) and the shared mail (Tr. 19037-38) markets, although only the former was disclosed in his prepared testimony.<sup>3</sup> Notwithstanding the postage rates about which it is so unhappy, ADVO has just completed its sixteenth (!) consecutive quarter of record profits, and Mr. Giuliano agreed that "at today's Postal rates" ADVO is "competitive and profitable" (Tr. 19041).

The reasons that the market can be in balance even if costs and rates differ are obvious. Postal delivery offers both the mailer (such as ADVO) and the advertisers many important advantages having nothing to do with cost, such as access to the mailbox, the "image" of the Postal Service and perhaps most importantly the avoidance of the burdens (financial and otherwise) of establishing and running an alternate delivery system. The record is littered with claims by mailers that they chose allegedly higher priced mail delivery because they want to concentrate on the non-delivery aspects of their businesses and not have to face the burdens of running a distribution network. See, e.g., witness Baro at Tr. 14393, witness Merriman at Tr. 15682, and witness Bradpiece at Tr. 18928. Alternate delivery in many cases offers advantages, such as date certain delivery, local accountability and lower prices in some cases. Those wishing to deliver product to consumers, and those that have product to be delivered to consumers, weigh these various and sometimes offsetting considerations and

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<sup>2</sup> Mr. Giuliano strained to avoid admitting the obvious (and the unexceptional)—that reduced postage rates would improve ADVO's relative competitive position (Tr. 19013-14).

<sup>3</sup> By contrast, even though Mr. Giuliano's testimony makes much of ADVO's alternate delivery expansion, after all, it has grown as a percentage of ADVO's total deliveries by a whopping less than one half of one percent per year for the past eight years (Tr. 19001-02), it is noteworthy that its most recent annual report and its web site make no reference to alternate delivery (Tr. 19022-31). This silence appears to be an appropriate reflection of ADVO's commitment to alternate delivery when and where it is not threatening to abandon the Postal Service.

reach a decision on what is best in their particular situations. Price and cost are not the only considerations. Wilson at Tr. 19142; Bradpiece at Tr. 18940; O'Hara at 21971, 21976-77.

Any change in the balance of the equation, whether in terms of service or in terms of cost, is going to affect the decisions reached, irrespective of which form of delivery is less costly or which carrier offers the more desirable service. O'Hara, Tr. 21976-77. It therefore follows that a reduction in postal rates that reaches double digits, especially when it is understood that rates will hold at that level for at least two years, will cause those now using mail and those now using alternate delivery to reconsider the factors that led to the present selection. The rate reduction will tip the existing balance in favor of the Postal Service and those like ADVOC that use its services, and it follows that volumes will move to reflect the new relationships.<sup>4</sup> As Mr. White noted (Tr. 9946-47), his members will continue to face inflationary pressures on costs and therefore prices, while, under the proposal here, its main competitor will offer lower, stable prices. The results ought to be obvious.<sup>5</sup>

In fact, as the Postal Service may know from the redacted portions of the SAI reports if they accurately reflect the facts, the alternate delivery industry, while surviving, is struggling to do so. The record shows that it is faced with high costs and a scarcity of unskilled labor while battling the constant problem of convincing skeptical advertisers that alternate delivery can be trusted (Tr. 19146). Typically, as a result, alternate delivery companies operate with "razor thin margins" (Id.). AAPS membership has dropped by 66% in the past five years (Id.).

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<sup>4</sup> Witness Wilson noted (9) that major daily newspapers in (among other places) Chicago, Boston, Los Angeles, Baltimore, Milwaukee, Atlanta, Washington DC, Cincinnati, Cleveland and Sacramento had recently moved their TMC programs from alternate delivery to mail. Poor postal delivery (not cost) has kept New York's *Newsday* in alternate delivery.

<sup>5</sup> See the testimony of William Wilson, who explained that after the rate changes in MC95-1, Knight Ridder shut down most of its alternate delivery businesses and moved the volumes back into the mail (Tr. 9135-36). He specifically stated (Tr. 19142) that the loss of magazine revenues made mail delivery more economical.

The Postal Service knows that alternate delivery volumes are very susceptible to diversion, which is why it keeps trying to increase its volume by lowering prices. Mr. White (Tr. 9947-48) details the history of the Postal Service's "now you see it, now you don't" recognition of its competition with the alternate delivery industry. In this proceeding, having been unsatisfied with the results of the prior one (in which the Commission refused to lower the pound rate), the Postal Service is in a "now you don't" mode, but to no avail.

The Postal Service continues to retain SAI to study our industry and provide advice to the Postal Service on how to deal with us. It is regrettable that the Postal Service will not reveal the contents of these studies, even subject to protective conditions.<sup>6</sup> But it is disgraceful that the witnesses entrusted with considering the impact on competitors and competition as mandated by statute have been systematically isolated from, or have isolated themselves from, the very documents that would be crucial to such an examination. Ms. Mayes has not read the studies (Tr. 4062), although we must wonder how she knows that they are (if they are) "anecdotal" if she has not seen them. USPS witness Moeller recalls a controversy surrounding the SAI reports in Docket No. MC95-1, but he did not bother to look at the study addressed in that docket or at any of the updates (Tr. 3834). Even the raising of the issue again in this case did not prompt Mr. Moeller to look at this obviously relevant material (Tr. 3838). Finally, Dr. O'Hara, the Acting Director of Pricing for the Postal Service, knew that the nature and existence of the SAI studies were once again raised in this case and, despite their obvious relevance to the statutory command to consider the impact of rate changes on private sector competitors, he too failed to read the SAI studies. Tr. 21961.

It cannot be mere coincidence, and it puts a great strain on credibility to believe, that for several cases not a single one of the several Postal Service witnesses presenting testimony on the consistency of proposed rates with the statutory standards has read the SAI reports and, as

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<sup>6</sup> The redacted versions contained in LR-268 are very heavily redacted.

Dr. O'Hara testified (Tr. 21963), that they were not instructed to avoid them. In our experience, Postal Service witnesses are too responsible to ignore such relevant information.

Rationalizing this apparent contradiction becomes even more difficult in light of Postal Service witnesses' testimony such as that of Dr. O'Hara in Docket No. R97-1-1 (quoted by Mr. White here at Tr. 9155) that "a quantitative assessment of the effect on competitors would require information on competitors' costs, prices, and volumes, and as far as I am aware this information is not available. . . ." In this docket, Dr. O'Hara must have known that the information is indeed available, just as witness Mayes must have known of the reports yet testified about impact on competitors without looking at them (Tr. 4196), while decrying the lack of available information about the "cost structures, rates, pricing and other practices" of alternate delivery companies (Tr. 4197).

AAPS does not in any way accuse any of these witnesses of failing to tell the truth. The only logical conclusion that follows, therefore, is that each of these witnesses in each of these cases either made no effort to determine if the Postal Service had in fact gathered information on the alternate delivery industry or, in those cases where they knew of the reports, they made a conscious choice not to obtain the best and perhaps only comprehensive results of studies of the alternate delivery industry. AAPS submits that such (dare we say "struthious"?) behavior is inconsistent with the Postal Service's statutory responsibilities.

The failure of the Postal Service to examine its own studies would perhaps be less of a disgrace if its witnesses had access to and used other sources for this information. Yet Mr. Moeller testified (Tr. 4019) that he relied upon nothing beyond his own testimony regarding the impact of the proposed rates on the competition provided by alternate delivery and (Tr. 4020) that he made no inquiry and did no research on the alternate delivery industry.<sup>7</sup> It is not enough

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<sup>7</sup> There is nothing new here. For example, in Docket No. R84-1, the Postal Service made no effort to study the alternate delivery industry (Tr. 1251 in that docket); in Docket No. R87-1, witness Lyons could refer only to an article that mentioned newspapers but not alternate delivery (Tr. 3844 in that docket).

to assert, even if it were true in *this* docket as opposed to prior dockets, that the rates are not designed to injure competition. As Mr. White shows (19), the Postal Service admitted to its competitive motives in both Docket Nos. MC95-1 and R97-1, so that it must be held to be fully aware that a lowered pound rate would adversely affect competitors and competition. Without the SAI studies to tell us how much, we are left with a record in which alternate delivery forecasts of competitive injury are met with (equally self-serving) speculation by mailers. The Postal Service has utterly failed to meet its burden of proof with respect to criterion four.

Those arguing for reductions in the pound rate because the present rates adversely affect advertisers and mailers raise arguments that are sometimes misleading, sometimes based on invalid comparisons and sometimes false. One such argument, raised by witness Crowder (Tr. 19416) and others, is that pricing flexibility is the exclusive province of alternate delivery companies, because postal rates are "fixed." She claims (*id.*) that "unlike" the Postal Service, Delivery Systems of Oklahoma (run by AAPS witness White), and presumably all other alternate delivery companies, have the flexibility to revise rates to reflect market conditions and the nature of the customer. What this argument intentionally overlooks is that when an alternate delivery company competes with ADVO, or with another shared mail program, or with a shopper, or with a newspaper<sup>8</sup>, it is not competing directly against the rate that the Postal Service might charge these delivery vehicles, but against the rates charged by ADVO, or the shopper, or the newspaper. Dr. O'Hara agreed that a great deal of the competition for alternate delivery comes from shared mailers, not from the Postal Service (Tr. 21975).

So the relevant question is whether, by using the Postal Service rather than a private carrier force as a delivery vehicle, the actual competitor that uses the mail is deprived of pricing flexibility. The obvious answer is "no." Ms. Crowder professed that "I don't know a lot about

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<sup>8</sup> While some would have the Commission believe that AAPS members are largely newspaper companies, Mr. White noted that only about 25% of the membership is affiliated with a newspaper (Tr. 9985).



ADVO's pricing" (Tr. 19416), which is not surprising since ADVO has *never* revealed its pricing in a Commission proceeding.<sup>9</sup> But Mr. Giuliano did admit (Tr. 19019) that ADVO can tailor its operations and procedures to reflect marketplace needs (notwithstanding his earlier testimony (Tr. 18999) that such flexibility is an advantage of alternate delivery).<sup>10</sup> Saturation mail witnesses willing to discuss prices were more forthcoming. For example, Mr. Merriman agreed that he will adjust rates depending upon volume and frequency (Tr. 15679), and Mr. Baro revealed (Tr. 14420) that he offers more attractive rates to advertisers "based on their volume and frequency." Such rates, he added (*id.*), are "negotiated" and "are not on our rate chart."

A related issue is the equally unavailing effort of saturation mailers to portray the *costs*, as opposed to the *rates*, of alternate delivery companies as far below Postal Service *rates*. Apart from the fact that this is the wrong comparison, these mailers have focused exclusively on delivery (and sometimes supervision) costs rather than the total costs of an alternate delivery company. Dr. Haldi (Tr. 18883-85) looked only at the delivery function and not at sales, advertising, administrative costs and other costs not directly related to delivery. Similarly, Mr. Bradpiece revealed only the delivery costs incurred in his newly acquired New York operation, and failed to include "central overhead" and such costs as the four additional employees devoted to the business, half of his own time (assuming he works a five-day week) and the time of his company's trainer. Mr. Giuliano's revelation of ADVO alternate delivery costs was not site specific and, although he thought that they were "fully loaded," the description in the testimony (Tr. 19000) does not appear to describe fully loaded costs.<sup>11</sup> Mr.

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<sup>9</sup> By contrast, Mr. White furnished his company's rate card (Tr. 9980-82), provided his range of rates for shoppers (Tr. 9974), offered additional rate information for specific types of delivery about which he was questioned (Tr. 10015) and revealed what DSO pays its carriers (Tr. 10017).

<sup>10</sup> When confronted with this apparent contradiction, Mr. Giuliano retreated to the assertion that this factor is an advantage for "both of us." Tr. 19020.

<sup>11</sup> "This includes the total delivery costs plus all costs for inserting preprints into the package, plastic bags and carrier supervision."

Giuliano apparently did not confirm with its source whether the numbers in his testimony are what he had asked for (Tr. 19048) and could not aid in resolving the issue by disclosing how much of the cost given consisted of direct carrier costs (Tr. 19046).

Moreover, none of these witnesses calculated the cost of the expensive "sweeping" function that many alternate delivery systems perform several days after the delivery function, when another force goes down the street to retrieve the packages left outside.

Another fiction that mailers may choose to argue, based upon the representation of Mr. Baro (Tr. 14389), is that major retailers such as K-Mart and WalMart, specifically identified by Mr. Baro, are not likely any longer to be found in shared mail but only in newspapers and alternate delivery. ADVO's web site proves to the contrary. It shows (Tr. 19043) not only that K-Mart and WalMart are customers of ADVO, but also that Pier 1 Imports, JC Penny, CVS, McDonald's, Ace, Pizza Hut, Sears, KFC, Burger King and Safeway are as well.

Once again, only the Postal Rate Commission stands between the Postal Service's goal of securing a much larger share of the mailed advertising business, at the expense of both competition and competitors, and achievement of that goal. We offer for the Commission's consideration once more AAPS witness Bradstreet's assertion in Docket No. R97-1 (Tr. 12051 in that docket) that it is especially important for the Commission step in, because now, as then, there is a sense of equilibrium in the market. Many publishers have long mailed their products, because they view the present pound rate as a good deal and will certainly continue to view it as a good deal if it remains as is. Others, including some former AAPS members and many major newspapers, have more recently shifted to the mail. Some use alternate delivery. Mr. Bradpiece's company, and now maybe even to a very small extent ADVO, are apparently comfortable using both. In Mr. Bradstreet's words there:

appears to be a balance between postal and alternative delivery where postal volumes are growing and where alternate delivery, though in many cases struggling, is able to compete somewhat effectively. A substantial reduction in the pound rate will tip that

balance heavily toward the Postal Service at the expense of alternate delivery providers.

The record will not support a reduction, and AAPS calls upon the Postal Rate Commission to reject again the proposal for a reduced pound rate.

Respectfully submitted,

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September 13, 2000

#### **CERTIFICATE OF SERVICE**

I hereby certify that I have this day served the following document upon all participants in this proceeding in accordance with section 12 of the Rules of Practice.

Bonnie S. Blair

Bonnie S. Blair